ESO 1985

1993
Agricultural Outlook Overview

National Economy
Agricultural Policy
Farm Income and Finance

Prepared by

Luther Tweeten
Department of Agricultural Economics and Rural Sociology
The Ohio State University

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National Economy

The national economy shifted from reverse to low gear in mid-1990. Its been stuck in low ever since. At issue is the implications of slow economic growth for American agriculture.

Slide: Economic Growth Slow But Positive

Gross domestic product growth has been slow and uneven but positive since the first quarter of 1991. I anticipate continued recovery and a national economy real growth rate in GDP of 2.6% in 1993.

That growth rate equals the average rate for 1976-90 but its not good news for two reasons. One is that the economy normally grows at twice that rate right after a recession. Another is that the slow growth will only reduce the unemployment rate from the current 7.5% to 7.0%. That won't help farmers who depend on off-farm employment.

Fortunately, in this sluggish national economy, demand for farm output isn't much affected by national income and employment. The national economy now influences agriculture mainly through trade and inflation, interest, and exchange rates. In 1993 inflation is expected to average only 3% and the prime rate 6%. The value of the dollar will average 75% of its 1985 value. These rates are all supportive for agriculture.

Slide: Widening Interest Rates Signal Monetary Expansion

An attempted expansionary monetary policy is apparent from the increased divergence between short- and long-term interest rates. The 3% interest rate on short-term T-bills is a result of the Federal Reserve's effort to inject money into the economy and reduce the discount rate.

The long-term interest rates have hardly budged because the market expects inflation to revive in time. The interest rate on 30-year, long-term bonds is just under 8% and has dropped little despite the recession. That long-term rate reflects a real rate of interest of about 2.5% percentage points plus about 5% expected long-term inflation. If money supply is expanded too rapidly, the long-term rate will begin to *rise* even as the short-term rate *falls*. The long-term rate will rise because the market will expect more future inflation.

Promoting economic growth with monetary policies is like pushing the economy with a string. Consumers and investors won't spend until they are more confident of the future. A more expansionary monetary policy could set off alarm bells for consumers and the Treasury because it will indicate that expected future inflation is expected to rise. The Federal Reserve has probably expanded money supply about as fast as it can and short-term interest rates can't fall much further.

Slide: Exchange Rates Fall

Falling exchange rates are a product of falling interest rates and recession. There is relatively little demand for U.S. dollars in foreign exchange because investors can obtain a better return in Germany where interest rates are high. The low exchange, interest, and inflation rates are generally favorable to American agriculture.

Ohio's economy has been performing somewhat better than the national economy as indicated by the following unemployment rates:

	Unemployment Rate (%)		
	July	August	September
Ohio	7.1	6.9	6.3
U.S.	7.7	7.6	7.5

Ohio has been helped by its strong export position enhanced by the low value of the dollar. Ohio was not far from full employment in September.

Slide: Top Six Markets Take 70% of U.S. Ag Exports

Recession hits agriculture indirectly through international linkages. Recession in the U.S. tends to depress economies abroad as we reduce imports from them. Of particular concern is what is happening to the economies in major markets for U.S. farm exports. Japan, the EC-12, and Canada are our largest customers but Mexico, the Soviet Union, Korea, Taiwan, and China-Hong Kong follow close behind. Our exports to these latter and other developing countries nearly equal those to developed countries. Japan and Germany entered the recession late and their economies are expected to continue to lag in 1993.

Slide: Economic Growth Rates Expected to Rise

Global recession is not over but foreign growth rates are expected to improve. The projections in the slide are taken from the U.S. Department of Agriculture and appear to be optimistic for 1993 with a projected growth rate for the world (excluding the U.S.) rising from 0.3% in 1992 to 2.8% in 1993. Developed countries are forecast to double growth rates and developing countries are expected to maintain their high growth rates, led by countries of East and Southeast Asia. The Eastern European countries including the former Soviet Union are expected to show a small positive growth after a 12% decline in 1992.

The positive elements for agricultural exports (low dollar and rising world income) will be offset by the large crops of coarse grains and oilseeds. Consequently, U.S. agricultural exports are expected to remain almost unchanged, going from $41.5 billion in 1992 to $41 billion in 1993.

Slide: White House Projects Lower Deficits

The chief impediment to a quick U.S. recovery is large budget deficits and debt which foreclose the use of fiscal policy as a tool to bring us out of recession. Postponement of savings and loan bailout funding to fiscal 1993 reduced the budget deficit in fiscal 1992 from an earlier estimate of $333 billion down to $290 billion. That is likely to mean an even larger deficit than the $341 projected by the White House for 1993. Washington has a consistent habit of underestimating deficits in future years so forecasts should be interpreted with caution.

Slide: Low But Rising Real U.S. CCC Net Outlays

Suggestions by experts to do something about the deficit almost always call for more cuts in government commodity programs. Outlays fell sharply after 1986 to a low in 1990. They have been rising since but are still a small portion of national income. The Export Enhancement Program has contributed to farm exports but is likely to be cut in the name of federal budget stringency.

Agriculture has a huge stake in sound, consistent monetary and fiscal policies. The industry needs to insist on such policies after the election. But even with sound policies we will not again see sustained economic growth rates of the 1950s and 1960s. The reason is large debts, slow-growing workforce, competition from abroad, and inability to automate the now dominant service industry. Slow growth is especially unfortunate because in the long-run per capita earnings of farm people are determined by per capita earnings of non-farm people.

Farm Policy and Trade

This section addresses three issues regarding the environment and five issues regarding trade.

Slide: Policy Issues - Environment

Applicators will be required to keep records on restricted-use pesticides beginning in 1993. Many farmers will find this to be a burdensome requirement. Only time will indicate whether the benefits will be worth the effort.

Of greater interest is issue 2 dealing with the Delaney Clause applied to pesticides and issue 3 regarding clarification of Swampbuster rules.

Slide: 2. Delaney Clause Applied to Pesticides?

The Delaney Clause came out of the 1958 Food, Drug, and Cosmetic Act prohibiting carcinogenic additives in processed foods. The Ninth U.S. Circuit Court in San Francisco has ruled that the law applies to pesticide residues in or on food. A ban could rule out 67 current pesticides including Treflan.

Several problems are inherent in application of the Delaney Clause to pesticides. First, the tests for whether a chemical causes cancer are highly suspect. Chemicals that cause cancer in rats administered massive dosages are frequently harmless at low doses, especially at the minute amounts found in food. Our instruments are getting good at picking up even the smallest trace element in food. It is unrealistic to reach zero tolerance. If we applied the Delaney Clause to natural carcinogens found in food, virtually every food would be outlawed! We take in 13,000 times as much carcinogens from natural as from synthetic sources.

The Environmental Protection Agency is appealing the ruling. It wants to continue to allow chemicals posing only *negligible risk.*

Slide: 3. USDA-Proposed Clarification of Swampbuster Rules

Farmland drained and cropped before 1986 is not under Swampbuster. In addition, the Bush Administration has made the proposal that land cropped or hayed 6 out of 10 years not be classified as wetlands to be protected under Swampbuster. That means that it is possible to repair tile and drainage ditches on such land. However, environmentalists have been plugging for much tighter restrictions based on physical characteristics of the land and not whether it has been cropped.

Slide: Trade Issues

Several trade issues can have a significant effect on future farm income.

The Democrats in Congress have long been pushing to revoke Most Favored Nation status for China in retaliation for the country's human rights record. If the Democrats in Congress renew their efforts and are supported by the President, the result could be a significant loss from the $1.7 billion China-Hong Kong market for our farm products.

A second important issue is the North American Free Trade Agreement which offers a potential U.S. market. NAFTA will be discussed by Norman Rask.

The confrontation with the European Community over pork and oilseeds continues. The European Community circumvented their pledge to allow soybeans and products into the Community duty free by subsidizing their processors who in turn pass the subsidy on to producers. The result was expansion in oilseed production which crowded out U.S. exports. The U.S. filed a complaint. A dispute settlement panel of the General Agreement on

Tariffs and Trade ruled twice against the EC. The European Community promised reform but so far has not done so. As a result, the U.S. is threatening retaliation.

Failure to reach agreement in the Uruguay Round has cocked the GATT triggers.

Slide: 4. GATT Triggers Cocked June 30, 1992

Legislation permits the Secretary of Agriculture to add $1 billion to the Export Enhancement Program, impose marketing loans for wheat and feed grains, and waive set aside requirements for wheat and feed grains if no agreement is reached in the Uruguay Round. These measures are likely to be delayed to fiscal 1994 which begins in October 1993. It is possible that the Secretary of Agriculture will not invoke them even without a GATT agreement if he deems that they would do more damage to the U.S. than to the European Community against which they are directed.

Slide: 5. EC Ag. Policy Reform

The European Community has agreed to modify its Common Agricultural Policy (CAP) along lines proposed by Ray MacSharry, EC Agricultural Commissioner. The MacSharry reforms of the CAP will go a long way toward changes called for in the Dunkel proposal which the U.S. said it would accept in the Uruguay Round. The CAP reforms proposed to be implemented between 1993 and 1996 will bring cereal price reductions of 29%, government payments to producers, and a 15% set aside of land. This is expected to lower cereal output by 5 million metric tons.

The lower prices will encourage consumption so that exports will fall from 30-35 million metric tons without reform to 25 million metric tons with reform. This compares with 22 million metric tons of exports expected by 1998 under the Dunkel proposal which calls for the 24% reduction in the quantity of exports subsidized.

In the case of oilseeds, prices in the EC will be allowed to fall to world levels. Farmers will be paid the world price plus payments designed to bring their oilseed returns to the level of cereal returns per acre. The overall impact will be to reduce production of oilseeds by 25% according to some estimates. That estimate is overly optimistic but any reduction will help U.S. soybean producers.

Beef and sheep price supports would be reduced 5% per year for 3 years, resulting in a 15% price reduction.

The overall effect of the reforms will raise CAP costs, currently $40 billion, by an additional $6 billion by 1996. It is questionable whether the European Community will be able to afford the revised CAP. Germany is in no position to bankroll the reforms.

Benefits to the United States from reform could equal those from NAFTA. Gains in U.S. exports initially could be $1 billion per year, and expand in later years.

Farm Income and Finance

Slide: Crop and Livestock Receipts About Even

U.S. farm income trended upward from 1986 to 1990. After peaking in 1990, income declined slightly and then has held fairly steady. Crop receipts, which lagged badly behind livestock receipts in 1986, have gradually improved and are about even with livestock receipts.

Slide: U.S. Farm Income Steady After 1990 Peak

Production expenses did not rise quite as fast as gross farm income to 1990, hence net farm income increased. Since 1991, net farm income has remained somewhat stable. In real terms, however, net income has declined.

Slide: Ohio Farm Income Declines After 1990 Peak

Ohio farm income has followed a pattern somewhat similar to U.S. farm income but has been more volatile. Farm income of Ohio has not quite kept pace with that of the U.S. mainly because Ohio farmers have tended to shift out of livestock in favor of off-farm employment. Ohio depends less on livestock than do other states on average. Drought in 1988 and 1991 also retarded Ohio farm income.

Slide: Ohio's Share of U.S. Farm Income Eroding

Ohio net farm income is a relatively small percent of U.S. farm income. The 1988 and 1991 droughts help to explain why the percentage seems to have fallen since 1986. The relatively high production expenses and low gross farm income relative to the national average explains the relatively low net farm income. Production expenses may be relatively high partly because Ohio has a high proportion of small farms. Gross farm income may be relatively low because of droughts and the shift away from livestock production as explained earlier.

Slide: Expected Change from 1992 to 1993, U.S. Farm Income

Despite lower prices, U.S. crop receipts are expected to increase slightly in 1993 because of the large harvest in 1992. Excess national supplies of livestock and attendant lower prices are expected to reduce livestock receipts by up to $2 billion. Direct payments as a result of lower crop prices are likely to offset so that total cash farm income is predicted to remain somewhat steady.

Turning to expenses, higher prices for manufactured inputs, repairs, and labor are expected to add $3 billion to farm costs in 1993. This will be offset by an estimated $2 billion drop in interest and farm-origin input costs, leaving a net increase in production expenses of $1 billion. The bottom line is a reduction in net cash income of $1 billion.

Slide: U.S. Farm Net Worth Steady Since 1990

U.S. farm asset values climbed from 1986 to 1990 and then leveled off. Meanwhile, farm debt declined and continues to stay at low levels. The result is substantial net worth.

Slide: Ohio Farm Net Worth Steady Since 1988

Ohio assets followed a pattern similar to that for the nation but peaked in 1988 rather than 1990 because of the 1988 drought hitting Ohio harder than most states. Nominal farm asset values have remained nearly constant since that time. That means that the real value of assets (adjusted for inflation) has declined. Overall debt in Ohio has remained relatively constant and low compared to the value of farm assets.

Slide: Ohio's Share of U.S. Balance Sheet Off Slightly

Ohio has a relatively low proportion of the nation's farm debt, in part because Ohio has a large number of small farms that on average have a low debt relative to their assets. The share of the nation's farm debt held by Ohio agriculture has remained almost constant since 1986. Ohio's share of farm assets has fallen somewhat. With a declining share of farm assets and constant share of farm debt, net worth has fallen but remained a nearly stable share of the nation's debt between 1989 and 1991.

Slide: Expected Change from 1992 to 1993, U.S. Balance Sheet

Real estate assets are expected to hold steady and non-real estate assets to rise a modest $1 billion in 1993.

Debt is expected to rise with assets: none for real estate and $1 billion for non-real estate. With assets increasing $1 billion and debt $1 billion the result is no change in net worth.

These numbers are not adjusted for inflation.

In real terms, assets and net worth are predicted to decline by nearly 3% in 1993. Ohio may do a little better than the nation because of the big crop in 1992.

Slide: U.S. Farm Financial Ratios A Little Less Favorable

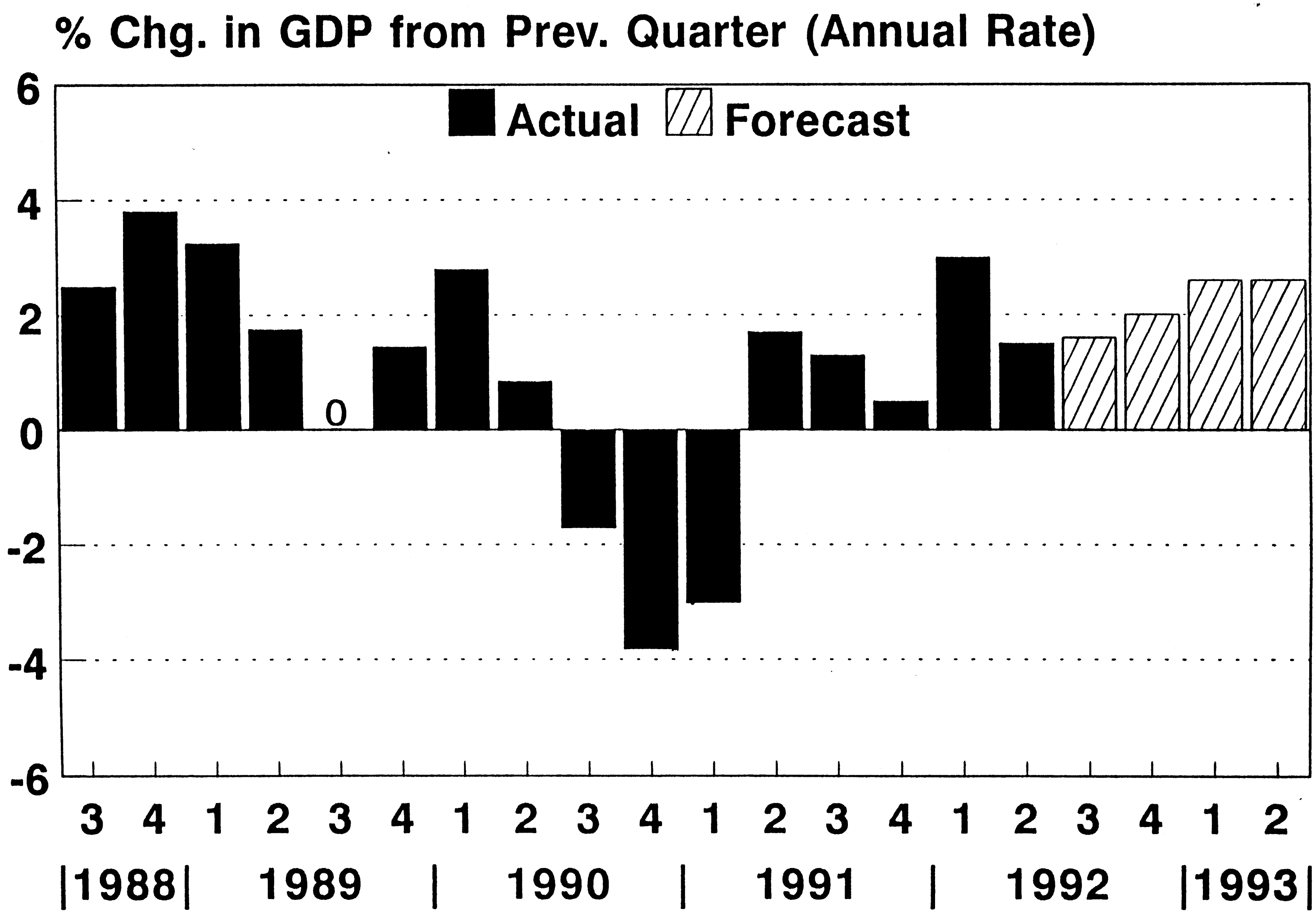
The favorable crop in 1992 as usual for agriculture is matched by lower prices so that real net farm income and the real net worth of Ohio farms are expected to fall somewhat in 1993. This will cause hardship on some farms.

The debt-to-asset ratio and debt-to-net farm income ratio provide some indication of the vulnerability of farmers to financial setbacks. Only U.S. numbers are shown because recent data are not available for Ohio, but the Ohio pattern for earlier years has tended to follow that of the United States.

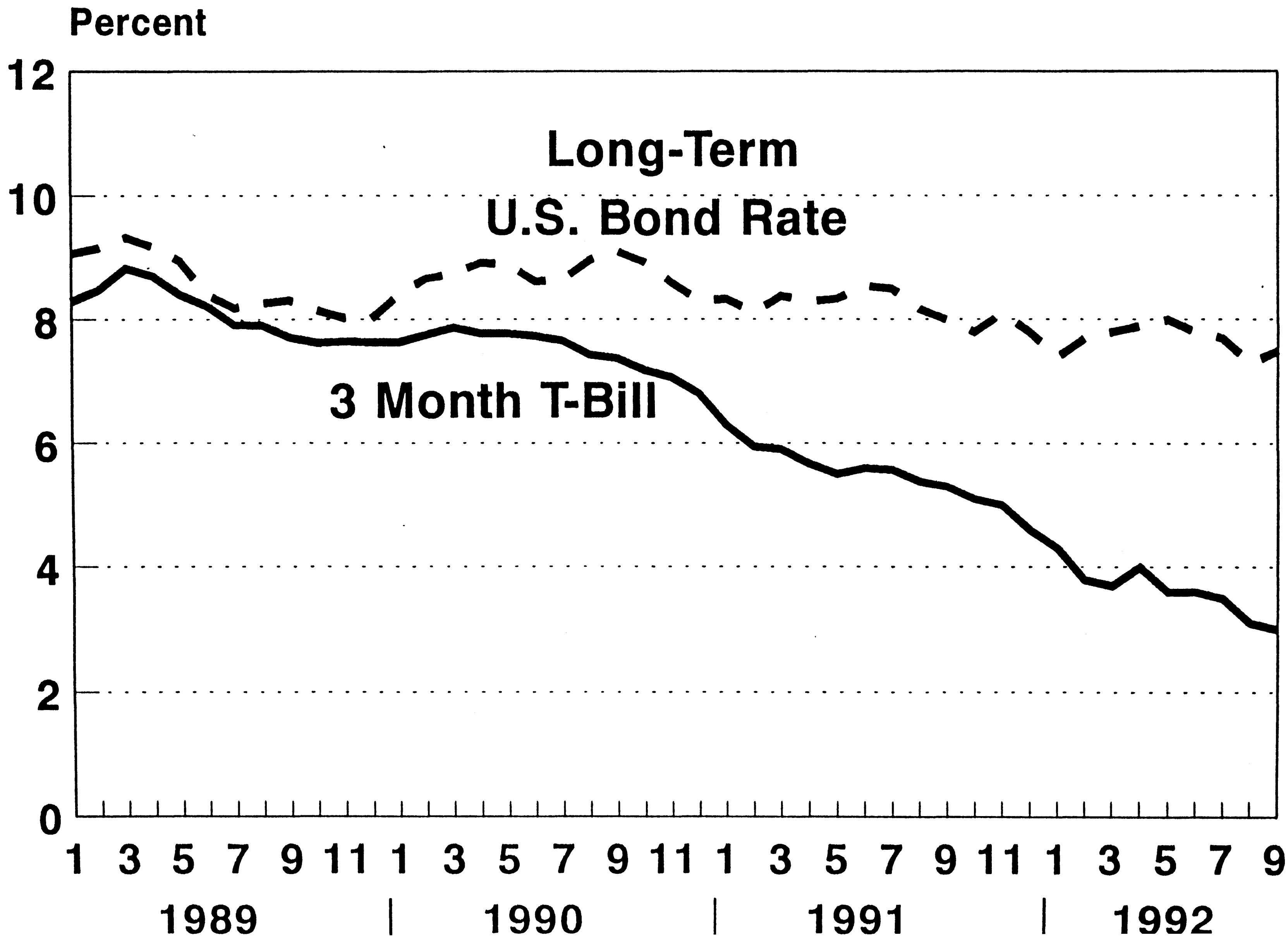
An increasingly strong financial position is apparent from the decline in the debt-to-asset ratio and debt-to-net farm income ratio from 1986 to 1990. Ratios have increased slightly since and are expected to continue to increase. However they are not at levels that indicate a financial crisis anywhere near the magnitude experienced in the mid-1980s. For farmers with high debt-to-asset and debt-to-income ratios the outlook is less rosy.

In summary, 1993 promises to be a year of tight profit margins. This is nothing new for farmers. The high production levels of 1992 remind us that world agriculture still has capacity to produce in excess of what the market will absorb. But the degree of excess capacity and the supply-demand balance are in better shape than in the 1960s and earlier years. With normal weather in 1993, the supply-demand situation can be expected to narrow and farmers will look forward to better times in future years.

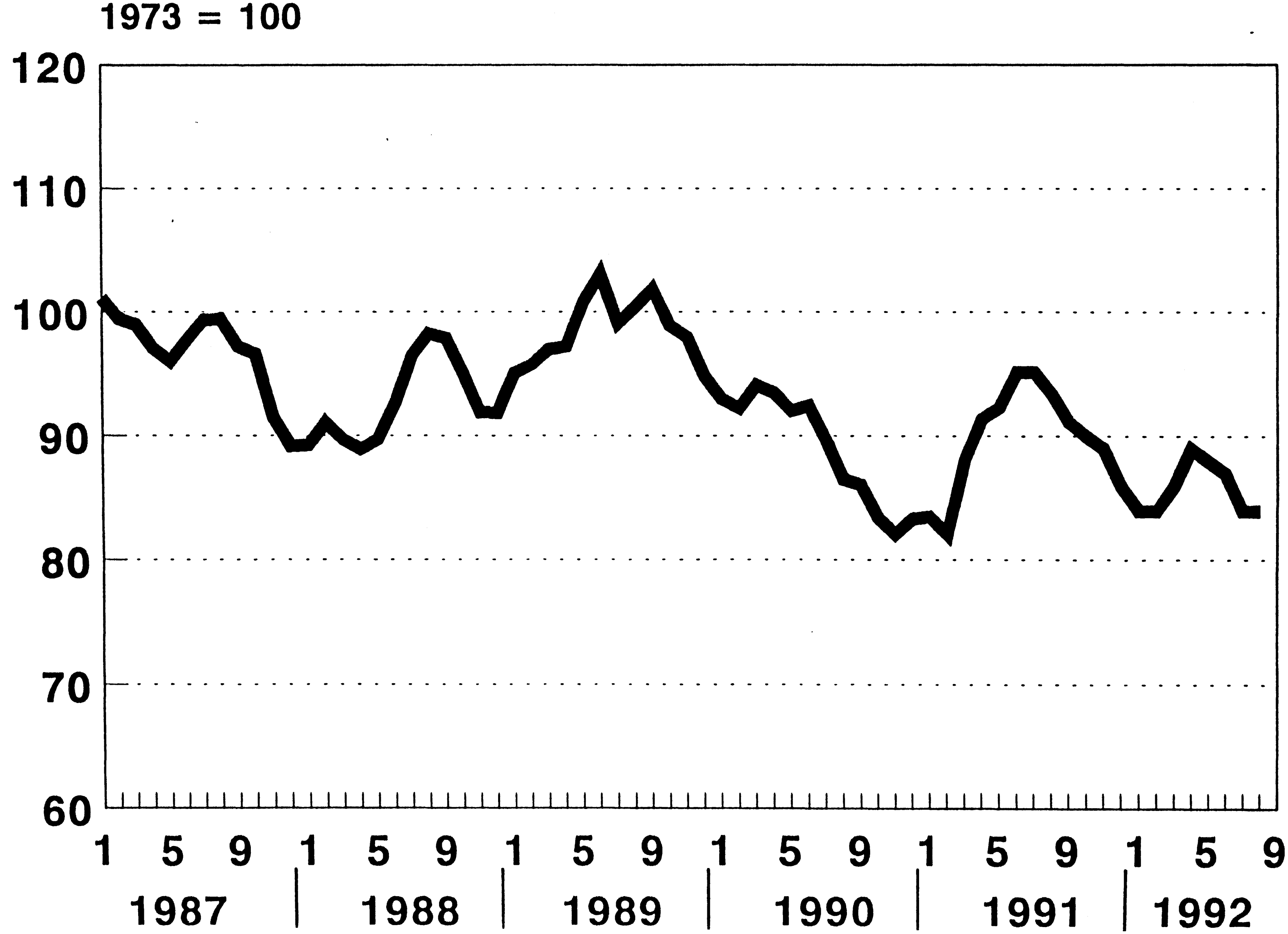
ECONOMIC GROWTH
SLOW BUT POSITIVE



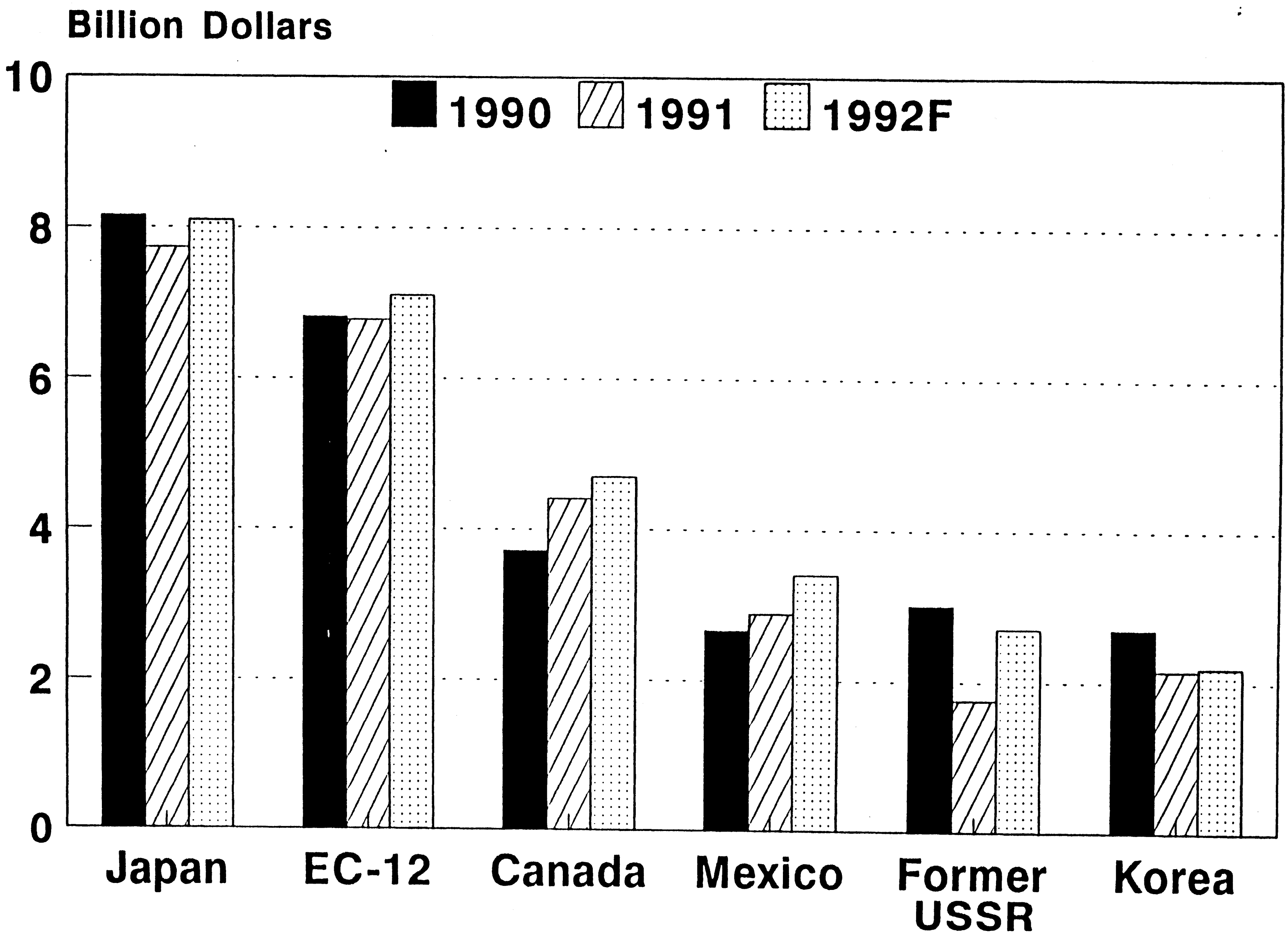
WIDENING INTEREST RATES SIGNAL MONETARY EXPANSION



EXCHANGE RATES FALL
Trade-Weighted Value of the Dollar



TOP SIX MARKETS TAKE 70% OF U.S. AG EXPORTS

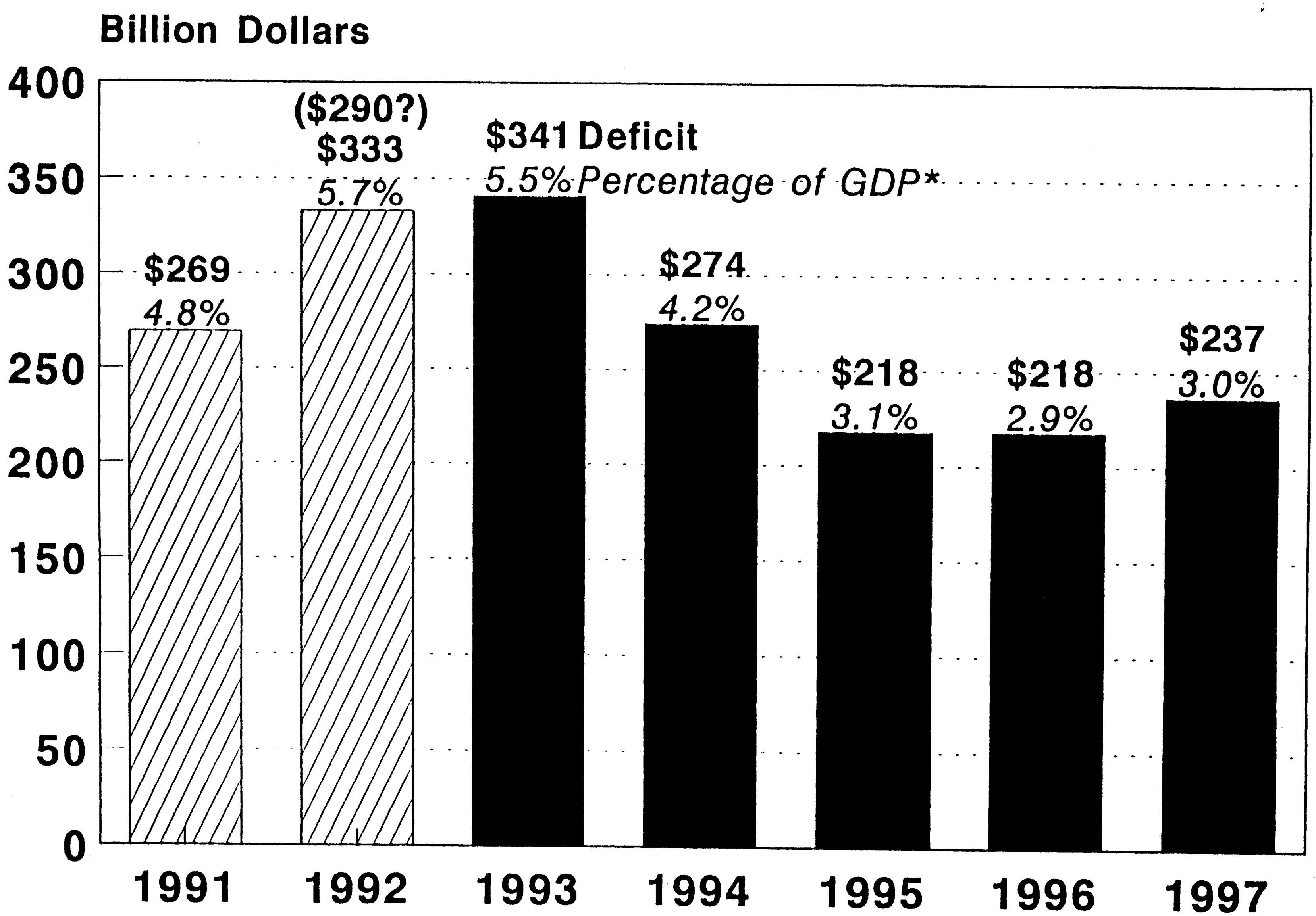


ECONOMIC GROWTH RATES EXPECTED TO RISE

	1992	1993F
Developed Countries (less U.S.)	1.2	2.4
Developing Countries	5.2	5.2
Eastern Europe and C.I.S.	−12.2	0.4
World Less U.S.	0.3	2.8
U.S.	2.0	2.6

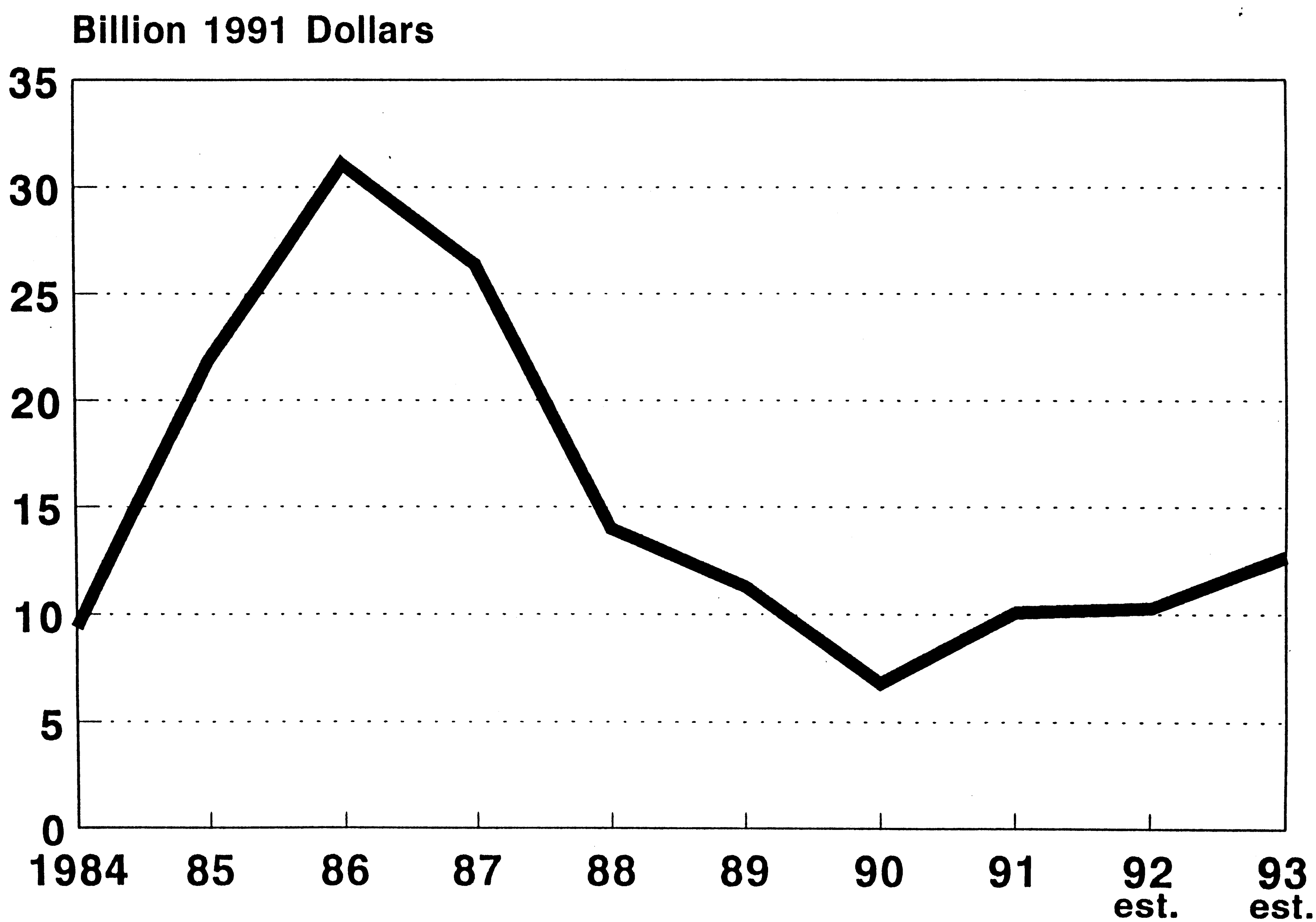
Source: USDA.

WHITE HOUSE PROJECTS LOWER DEFICITS



*Gross Domestic Product is the total value of all goods & services produced in this country.

LOW BUT RISING
REAL U.S. CCC NET OUTLAYS



POLICY ISSUES

Environment

1. Recording of restricted-use pesticides required in 1993.
2. Delaney Clause applied to pesticides?
3. USDA-proposed clarification of Swampbuster rules?

2. Delaney Clause Applied to Pesticides?

* Delaney Clause of 1958 Food, Drug, and Cosmetics Act prohibits carcinogenic additives in processed foods.
* Ninth U.S. Circuit Court (San Francisco) ruled that clause applies to pesticide residues.
* Could ban over 67 pesticides (e.g. Treflan).
* Test unreliable -- on rodents.
* Zero tolerance unrealistic.
* EPA appealing ruling.

3. USDA-Proposed Clarification of Swampbuster Rules.

<u>Proposal</u>

* Land cropped or hayed 6 out of 10 years not wetlands protected by Swampbuster.
* Can repair tile and drainage ditches on such land.

(Current law: Land drained and cropped before 1986 not under Swampbuster.)

<u>Timetable</u>

* Congress mandated that all farm wetlands be designated by end of 1994.

Trade Issues

1. Revoke Chinas's MFN status?
   (Lose $1.7 billion market?)
2. NAFTA.
3. Confrontation with EC over pork and oilseeds.
4. GATT triggers cocked.
5. EC policy reform.

4. GATT Triggers Cocked June 30, 1992.

* Add $1 billion to EEP.
* Marketing loan for wheat and feed grains.
* Secretary of Ag. waive set-aside requirements.

(If used, delayed until Fiscal 1994?)

5. EC Ag. Policy Reform.

* Cereals.

  Prices reduced 29% 1993 to 1996.

  Payments to producers.

  15% set aside, lower price cut output 5 mmt.

* Exports to 25 mmt from current 30-35 mmt.

  (Compares to 22 mmt by 1998 under GATT Dunkel proposal.)

* Oilseeds.

  World price + payments.

  Reduce production 25%.

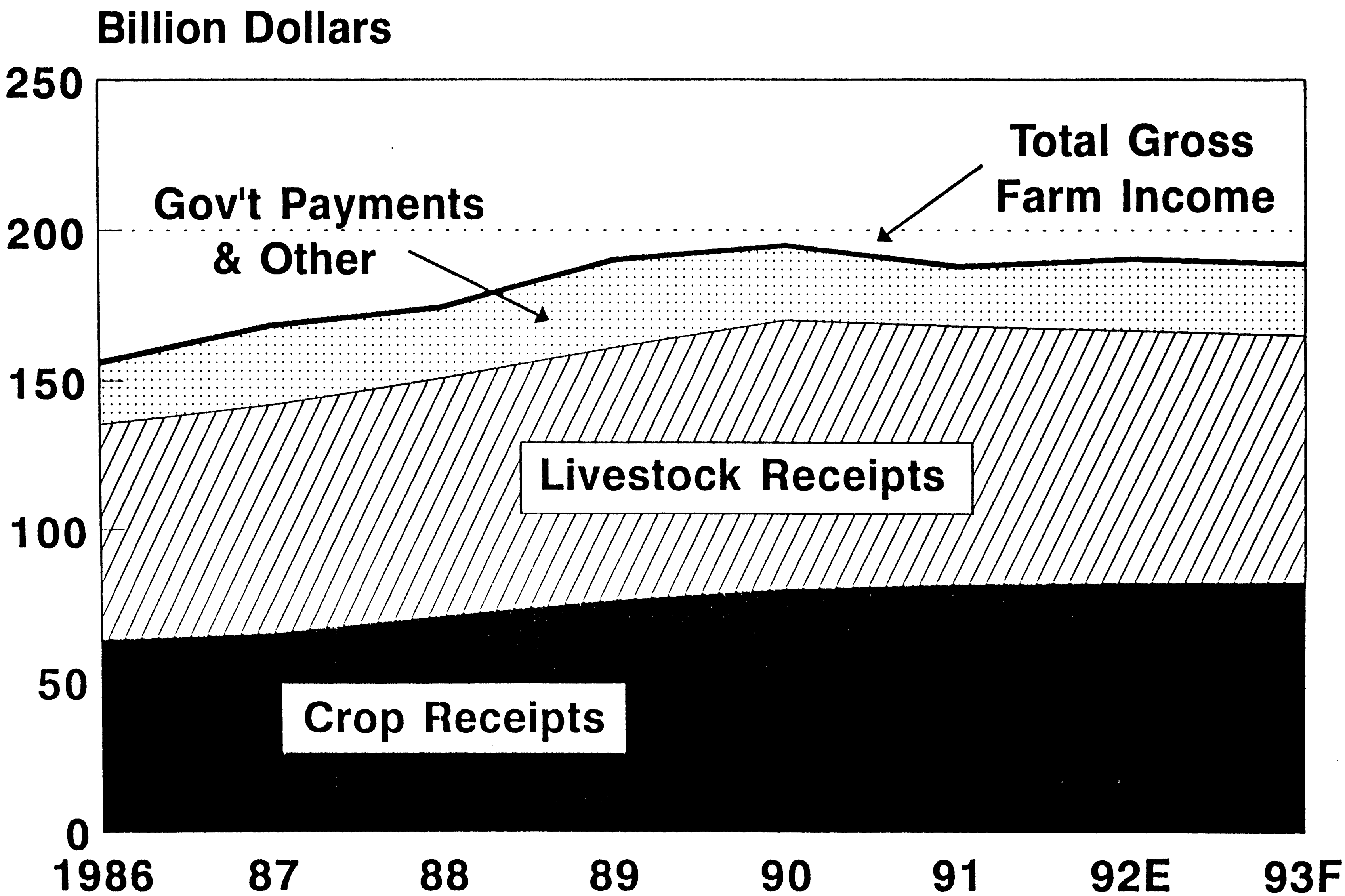
* Beef and Sheep.

  Price support reduced 5%/yr. for 3 years.

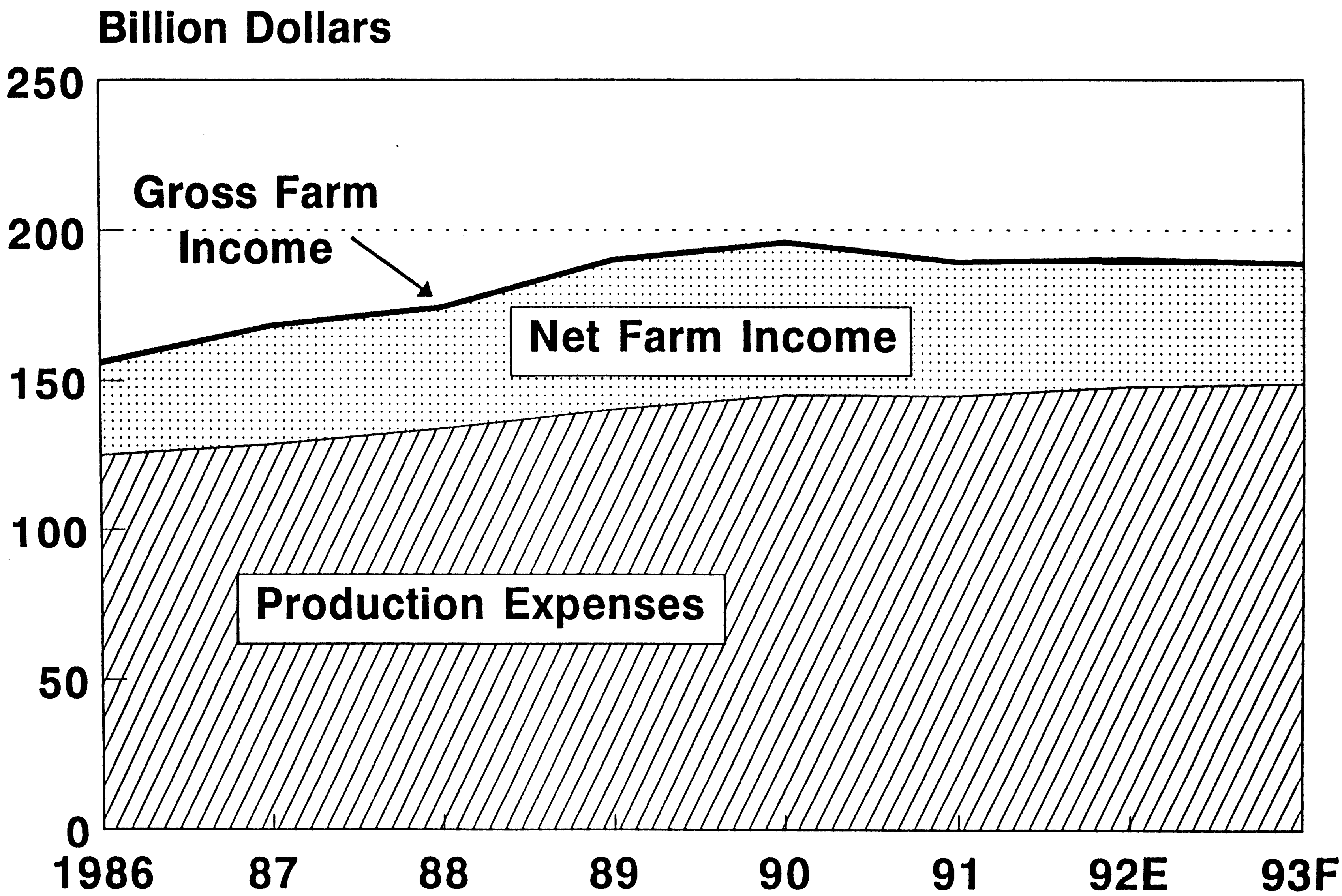
* CAP cost of $40 billion now to rise $6 billion by 1996.

* Benefits to U.S. could equal NAFTA.

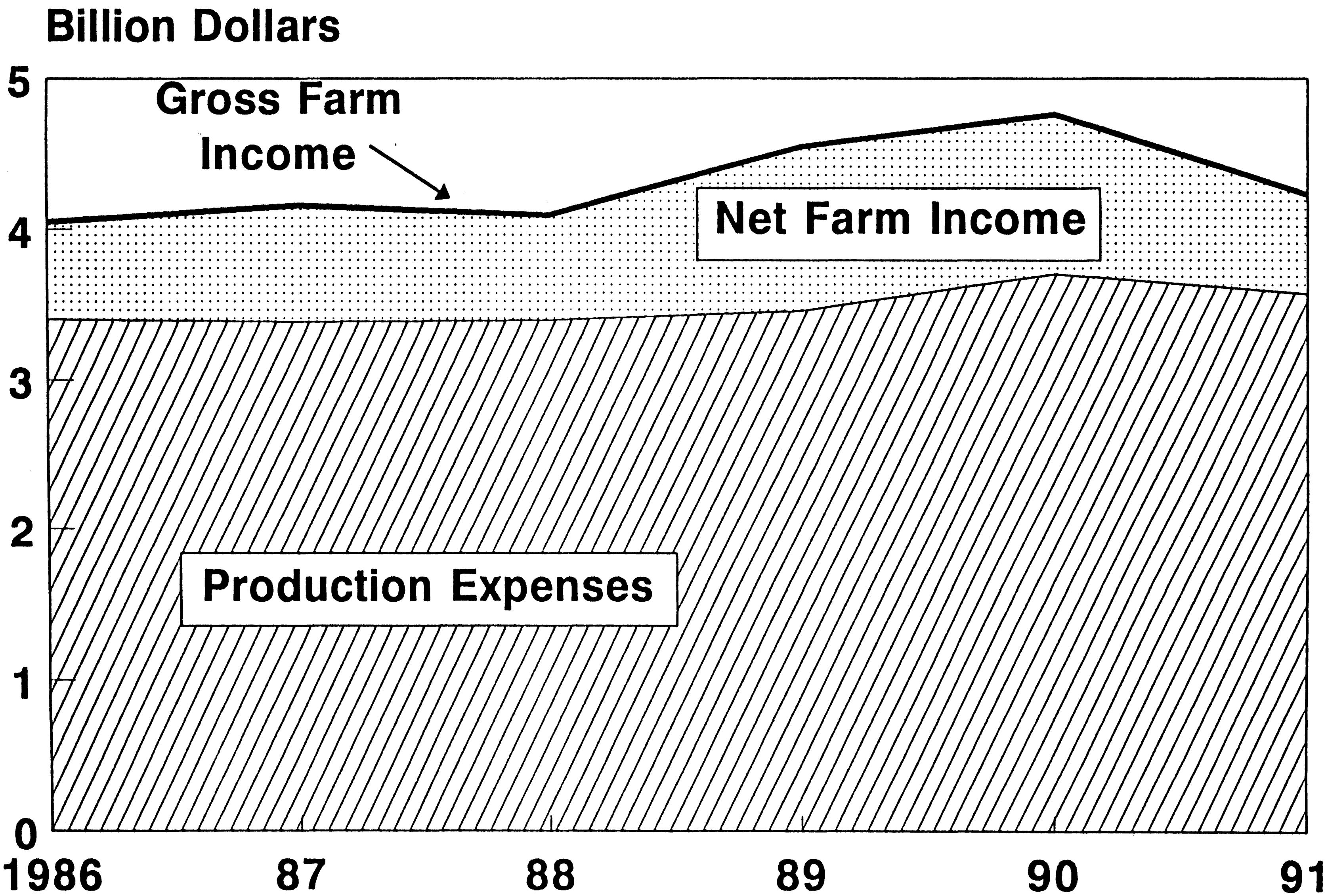
CROP AND LIVESTOCK RECEIPTS ABOUT EVEN



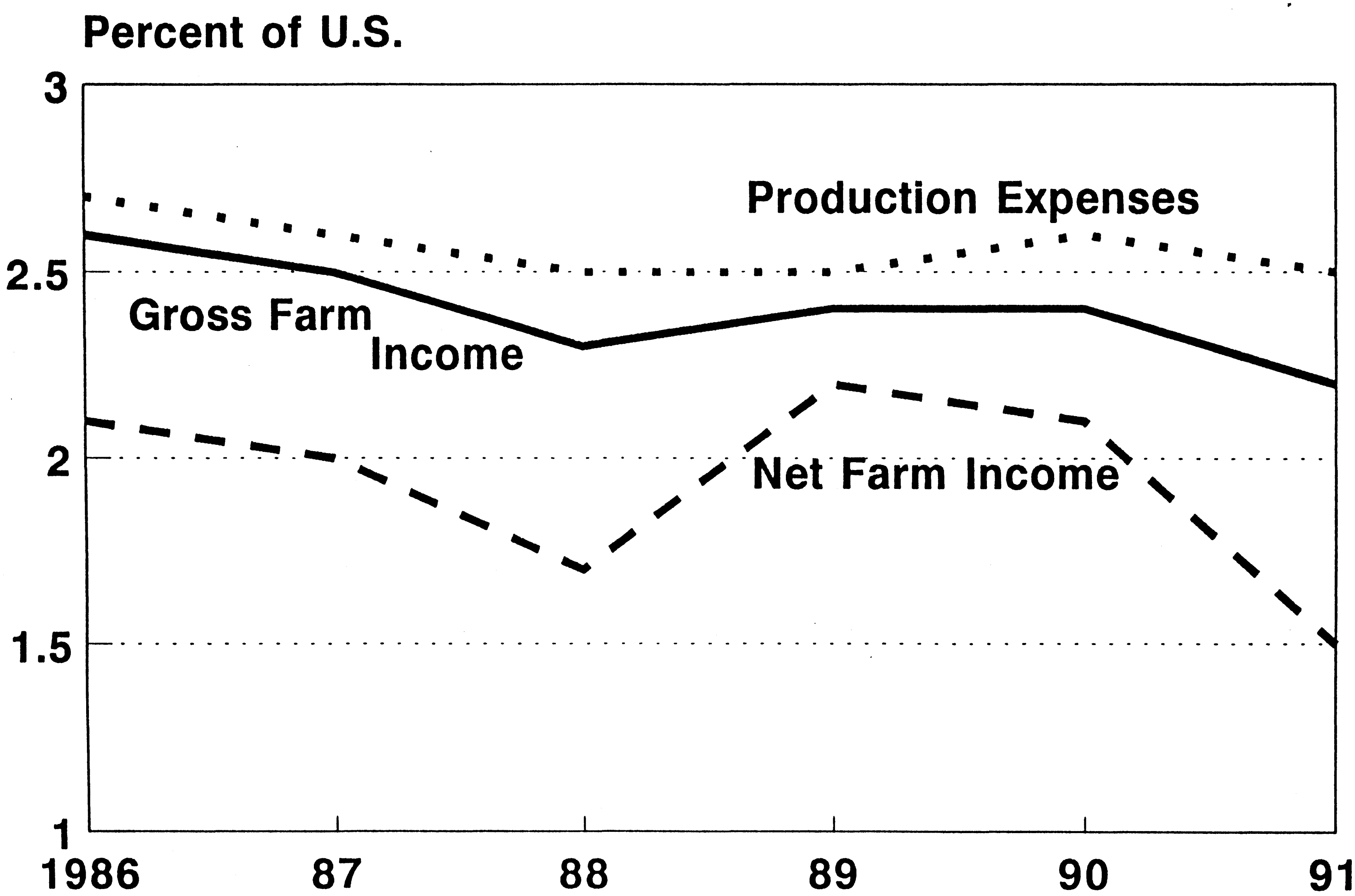
U.S. FARM INCOME STEADY AFTER 1990 PEAK



OHIO FARM INCOME DECLINES AFTER 1990 PEAK



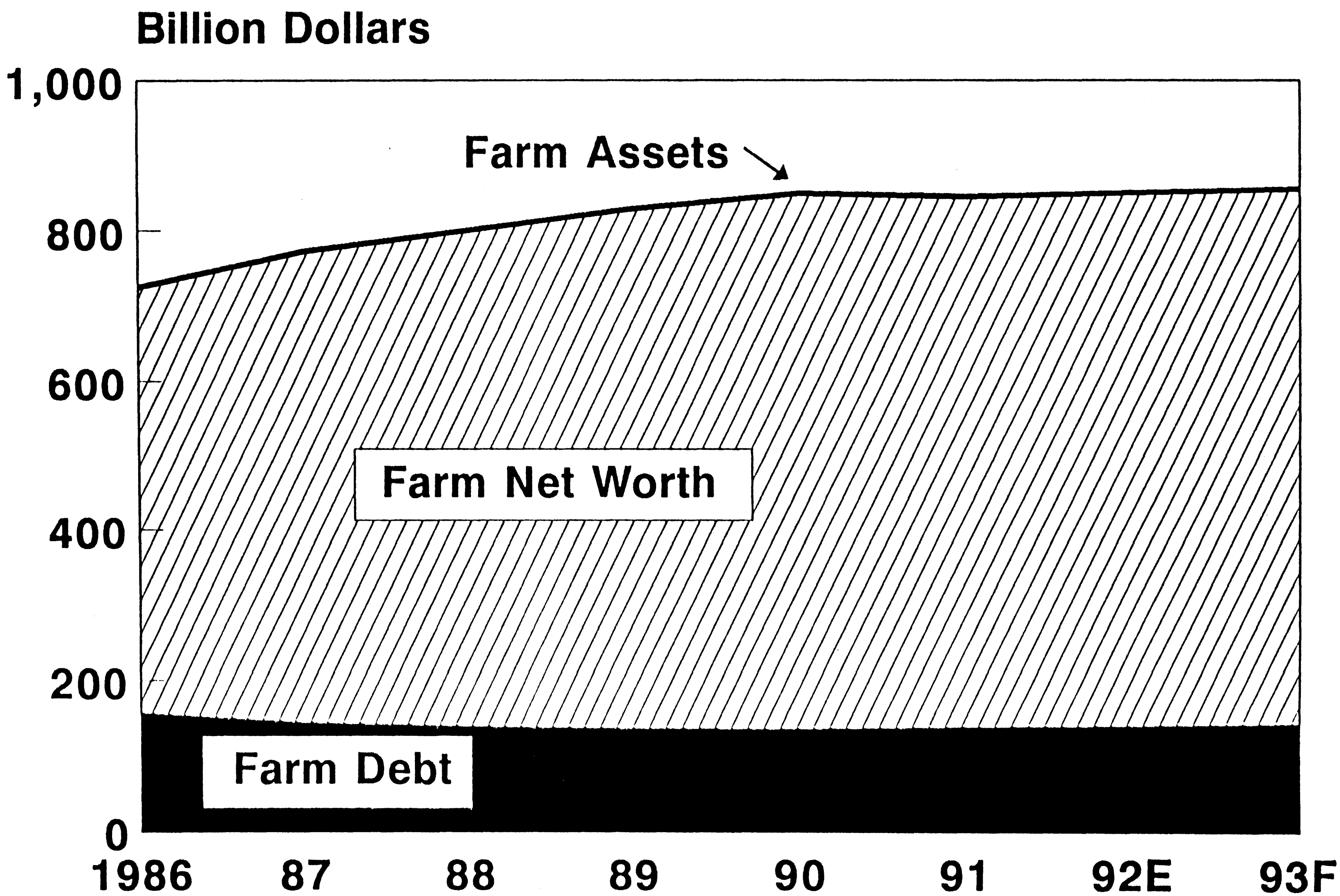
OHIO'S SHARE OF U.S. FARM INCOME ERODING



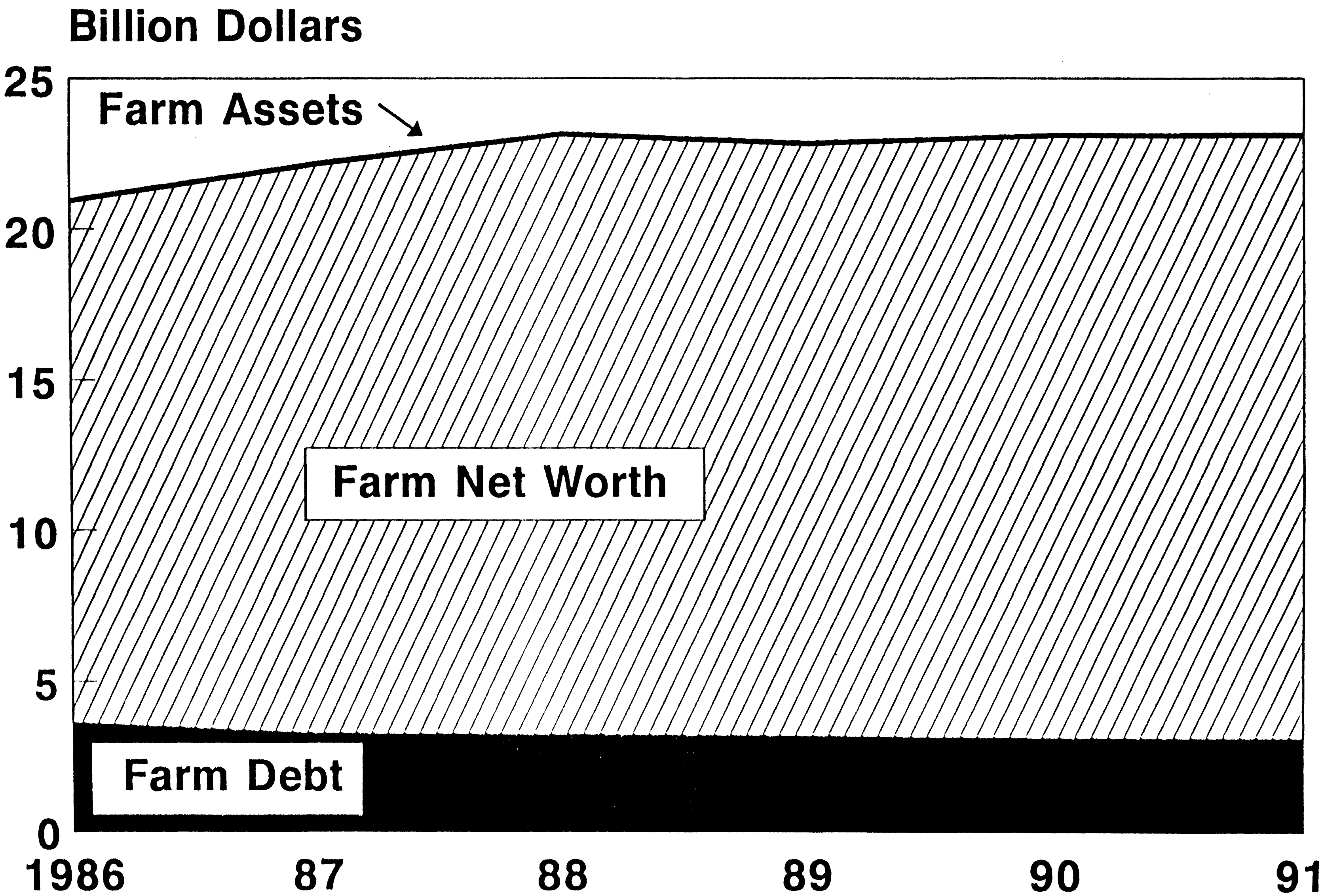
EXPECTED CHANGE FROM 1992 TO 1993, U.S. FARM INCOME

	($ Billion)
Receipts	
Crop Receipts	+ 0.5
Livestock Receipts	− 2.0
Direct Payments	+ 1.5
Total Cash Farm Income	+ 0.0
Expenses	
Manuf. Inputs, Repairs, Labor	+ 3.0
Interest, Farm-Origin Inputs	− 2.0
Production Expenses	+ 1.0
Net Cash Income	− 1.0

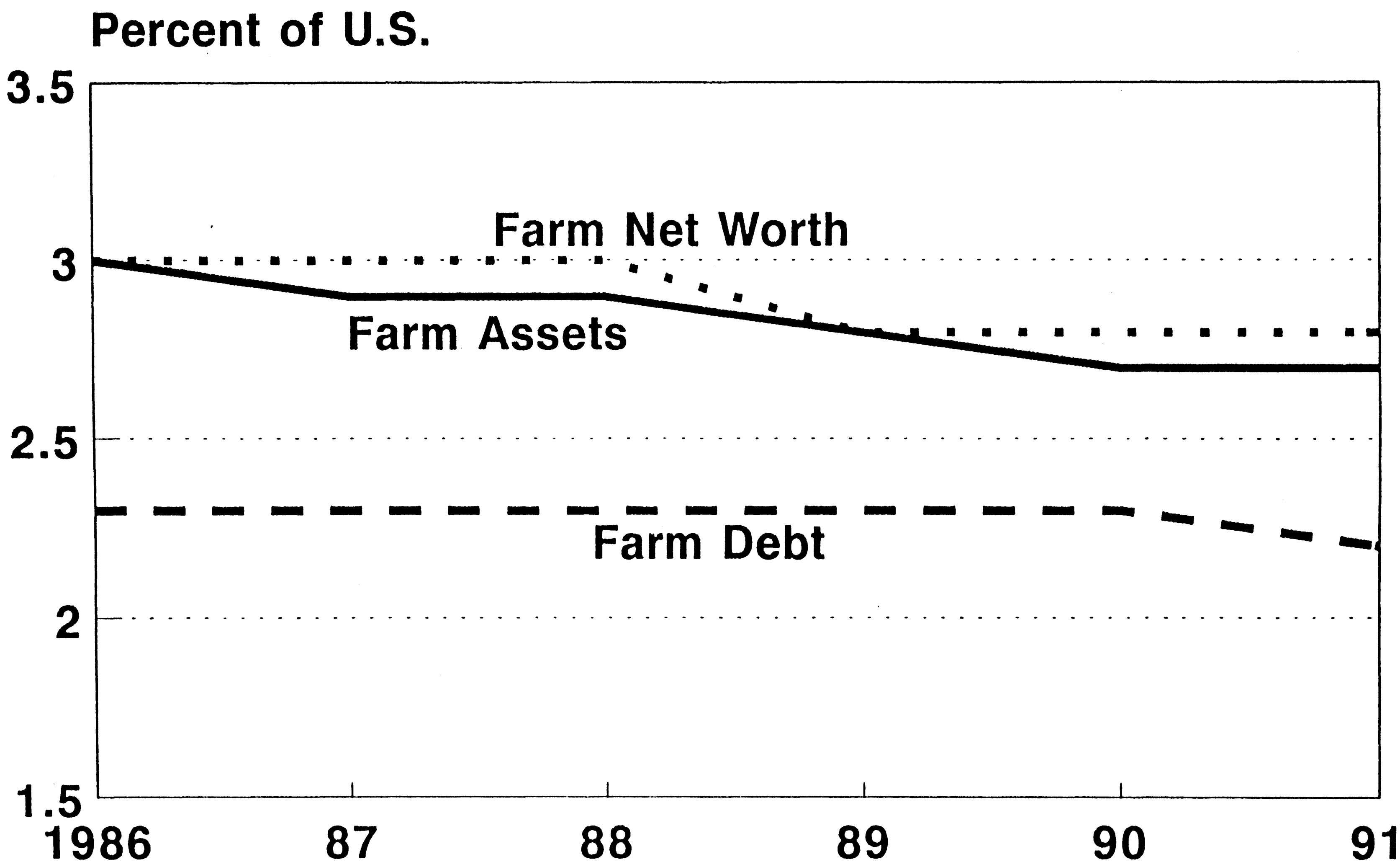
U.S. FARM NET WORTH STEADY SINCE 1990



OHIO FARM NET WORTH STEADY SINCE 1988



OHIO'S SHARE OF U.S. BALANCE SHEET OFF SLIGHTLY



EXPECTED CHANGE FROM 1992 TO 1993, U.S. FARM BALANCE SHEET

	($ Billion)	
Assets		
Real Estate	+ 0	
Non-real Estate	+ 1	
Total Assets		+ 1
Debt		
Real Estate	+ 0	
Non-real Estate	+ 1	
Total Debt		+ 1
Net Worth		+ 0

U.S. FARM FINANCIAL RATIOS A LITTLE LESS FAVORABLE